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Banking on housing?

Speculating on the role and relevance of housing wealth in Britain

Paper prepared for the
Joseph Rowntree Foundation

Inquiry into Home Ownership 2010 and Beyond

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This paper contains a round-up of evidence and opinion concerning the asset value of owner occupied homes. It is based on a wide range of recent literature, but is offered primarily as a ‘think-piece’. It is therefore selective rather than exhaustive; suggestive rather than definitive; provocative rather than prescriptive. It provides an account of the changing character of home ownership in Britain, paying particular attention to the individual and systemic risks that may be associated with this. The views expressed are those of the author.

February 2005

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Introduction

Owner occupied housing has always been recognised as both a consumption and an investment good. In both research and policy, however, it has, until recently, been the consumption element (housing as shelter, as service, as meaning-filled home) that has attracted most attention. This review addresses the other side of the coin. Housing is not unique in being both usable and a potentially appreciating asset (antique clocks, vintage cars and old teddy bears have some of the same features), but in Britain – much more so than in the USA, for example – housing wealth has become the most valuable, and sometimes the only, significant asset many households possess. In Britain today, not only do more people have more wealth in their homes than ever before, but this asset is (with a wide range of mortgage products at the interface) more ‘spendable’ now than it will ever be again. The cost is record levels of indebtedness in an economy driven more by credit than cash. This is the background against which any assessment of the changing significance of housing assets, of the fragile balance between savings and debt, and of their implications for the future of home ownership, must be set.

The discussion which follows begins by documenting *three key changes in the economic landscape* of home ownership in Britain: first, its *growing extent and appreciating value*; second, the increasing *fungibility of housing wealth*; and finally a (possible) *shift in political and social attitudes* to the asset value of owned housing. Looking to the future, the Council of Mortgage Lenders recognises in all these trends ‘the enormous contribution that home ownership makes to the social fabric of the UK, the wellbeing of individual households, and the policy objective of self provision’ (Anderson 2004, p. 12). But as with any housing strategy (and, arguably, more so than with many), its effects are uneven, and its benefits come with both risks and costs. This paper is primarily concerned with how to identify, limit and manage these risks and costs for individuals as well as for economies and societies.

The second section of this report therefore contains an overview of some of the *individual and systemic risks* associated with the changing character of housing assets in the UK. For *individuals*, these risks include: unequal access to, the financial rewards of home ownership; high levels of indebtedness combined with low social protection; and dependence on a narrow investment portfolio. *Systemic risks* associated with the wealth effects of owner occupation have a bearing on the wider economy (not least because of the way instability in house prices interacts with monetary policy). They also pose a challenge to politics (questioning a national housing strategy based on the sustainability of owner occupation), and have environmental repercussions (impacting on the future quality and condition of the housing stock).

The last section of the paper is concerned with the prospects for *mitigating the risks associated with the asset value of home ownership*. Rather than providing a list of key risks and possible strategies (which has to an extent been done before) this section is organised around the relative merits of two broad models. These models are not mutually exclusive. They both aim to maximise the benefits and minimise the risks associated with home ownership over the next ten to twenty years. However, they envisage rather different scenarios for the future of owner occupation. The first is an *evolutionary model*. It aims to promote the fairness and accountability of lenders while enhancing the knowledge and capability of consumers. The second might be termed a ‘*care-full markets*’ model. This is about the prospects for adopting a more flexible and imaginative, less individualised, and ultimately trans- or post- tenure approach to the wealth accumulated through owner occupation.

Housing assets: reshaping the economic landscape

i) The rise and rise of owner occupation

Working across almost any timescale, it is hard to overstate the shift in the extent and magnitude of housing wealth in Britain. In less than 100 years a nation of renters has been transformed into a society of home owner/buyers, so that, from a low of 10 per cent in 1914, owner occupation had reached 69% by 2001 (rising to 85% among mid-life households). In the half century 1951 to 2001, the housing stock as a whole grew by 80% while the number of homes in owner occupation increased by 320%. Home ownership is now more extensive than it has ever been in England and Wales. And as far as households are concerned there is still some way to go: 76% of households want to be home owners in two years time; 82% want to remain or become owners over the next ten years¹ (Anderson, 2004).

The factors underpinning this expansion of owner occupation into the dominant housing tenure in Britain do not need rehearsing here. What *is* worth considering is the way in which the tenure has been framed and reframed politically and culturally as the economic times have changed. In the early 1970s, for example, home owning might reasonably have been imagined, as Peter Saunders put it, as a form of ‘self-provisioning’, reducing households’ dependence on the state and increasing their autonomy (Saunders, 1990). But in the last quarter century, housing markets have been adjusting in far-reaching ways to a shift in the

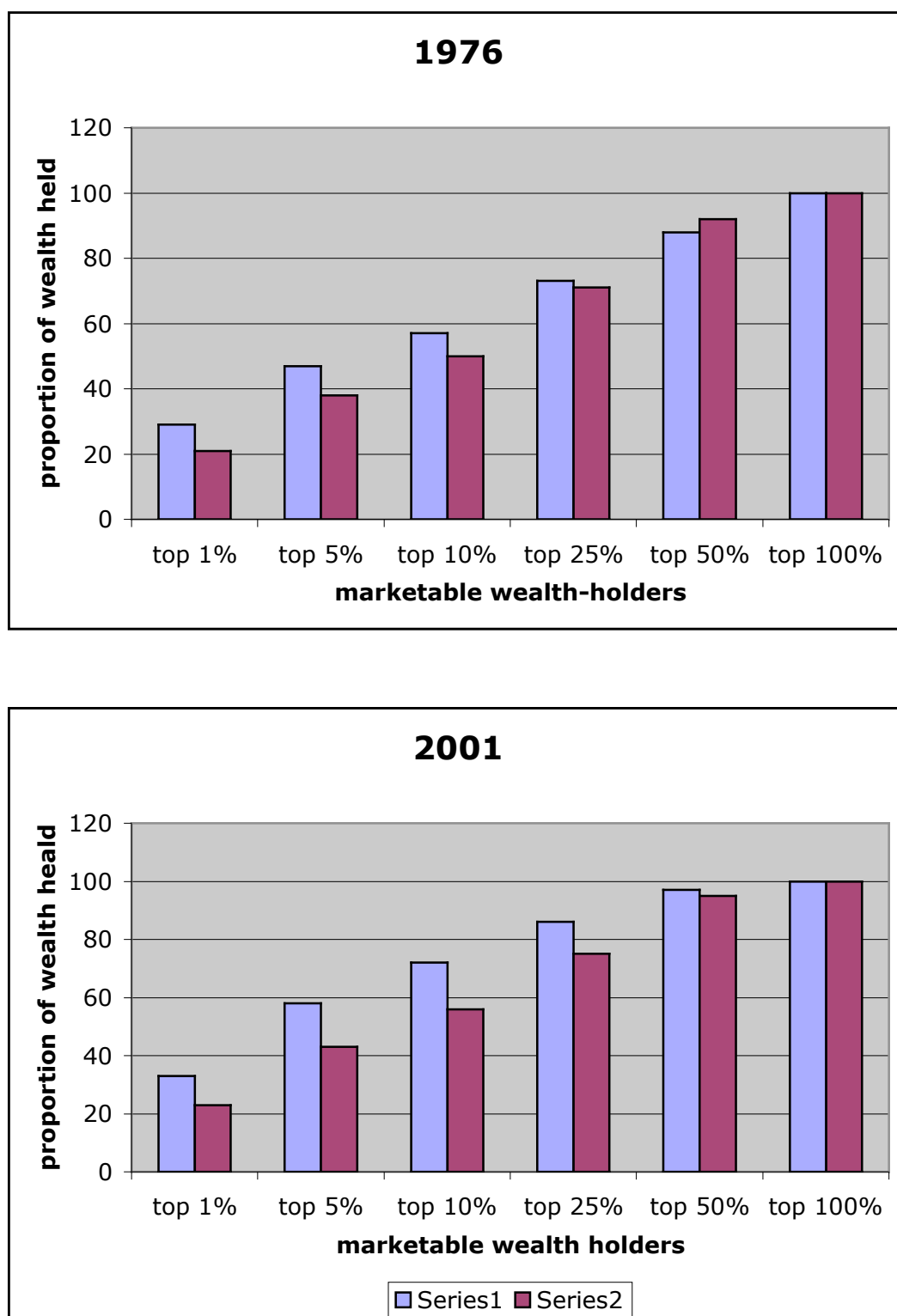
¹ In 1975 there was a much stronger aspiration to rent: 32% said they wanted to remain or become council renters over the next two years.

regulatory environment (which is described for the UK by Muellbauer & Murphy (1997) and set out more generally in Miles (1992)). Mortgage lenders, whose concern was once with product rationing, have been vigorously marketing their loans in an intensely competitive environment, and governments are looking to home purchase to provide (amongst other things) a route to social mobility. Some home-buyers have swapped dependence on the state for reliance on the market, and the UK population has effectively become a nation of small investors. Owner occupation is effectively populated by market actors who (for reasons, to an extent, and in ways, that remain to be documented) are competing against one another to secure the finance and protection they require in order to access to homes and neighbourhoods which – whatever other housing needs they do and do not meet – promise economic, educational and a host of other returns. And in some ways, it is the financial returns that have been most startling.

Although house prices are notoriously volatile, there have been four phases of marked and sustained house price appreciation since 1970 (with peaks in 1973, 1979, 1989 and maybe 2004), increasing the value of the owned stock to almost $\pounds 3 \times 10^{12}$ by the end of 2003. Indeed, the UK (together with Spain) topped the OECD league table for average annual increases in real house prices between 1971 and 2002². Between 1995 and 2002 the UK was one of only three OECD countries (the others being Ireland and the Netherlands) whose average annual increase exceeded eight per cent, and whose real rate of house price inflation (like that of only Spain and Ireland) averaged over three per cent per year. Since 2000 alone, prices have risen by 60% reaching an average of $\pounds 161\text{k}$ by early 2004 (ODPM, Survey of Mortgage Lenders). Adjusting for inflation, these prices exceed the peak of the 1980s boom (Vass, 2004) and the wealth of many owner-occupiers is accumulating faster in their homes than through their incomes. HM Treasury (2003) now recognises that, as an investment, housing has performed particularly well for the UK, to the extent that, by the end of 2003, the average (median) home owner/buyer had, amongst their assets, as much as $\pounds 56\text{k}$ of unmortgaged housing equity (Smith & Vass, 2004). While the asset value of housing makes little overall difference to the wealth inequalities that divide a country Britain, *figure 1* shows some intriguing trends.

² OECD countries referred to in this paper are the 18 included in the International Settlements' residential property price database, plus New Zealand (see **Catte, P., Girouard, N., Price, R. and Andre, C.** (2004), 'Housing markets, wealth and the business cycle', *OECD Economics Department Working Paper*, 394.).

Figure 1: Housing wealth and the distribution of UK marketable wealth 1976-2001



Source: Social trends/ HM Treasury

Note: Series 1 = marketable wealth excluding housing; Series 2 = including housing wealth

The two bar charts comprising *figure 1* show that disparities in all wealth have only widened in the last quarter century. Whether in the form of housing or not, marketable wealth is increasingly concentrated in the hands of the richest 10% (who own more than half) to the detriment of the least wealthy 50% (who own less than five per cent). More texture on the data to 2002 is provided by Paxton (2002). However, figure one also suggests that the distribution of housing wealth has an ameliorating effect on this polarisation. Between 1976 and 2001, the top five wealth deciles increased their grip on non- housing assets by between 4% (for the top 1 per cent) and 15% (for the top 10 per cent). But when housing assets are added to the mix, these increases are cut by between a half (for the top five per cent) and two thirds (for the top 25 and 50 per cent). Moreover, between 1976, when housing assets accounted for 30% of all marketable wealth, and the decade 1991-2001 (when housing assets increased their contribution by up to 10%)³ the effect of the distribution of housing wealth on the proportion of wealth held by the least wealthy changed direction. In 1976, while housing wealth detracted from the polarisation of wealth into the hands of the wealthiest 25% of the population, it marginally increased the concentration of assets into the top half of the wealth hierarchy (expanding the wealth holdings of the top fifty per cent from 88% to 92% of the total). In both 1991 (not shown in figure 1) and 2001, however, housing assets spread the distribution of wealth slightly further down the hierarchy in relative (though not absolute) terms (reducing the wealth holdings of the top fifty per cent from 97% to 95%). Now that owner occupation has expanded to accommodate half the poor as well as most of the rich, and the value of the housing stock has once again been appreciating, the distribution of housing wealth is (in relative terms) marginally improving rather than substantially detracting from the position of the bottom half – indeed 3/4 – of the wealth hierarchy.

Of course this ‘bottom three-quarters’ includes the majority of the population, in what is becoming a highly unequal society. It has, moreover, long been recognised that differential house price appreciation (reflecting differences in the desirability of locations or neighbourhoods, as well as variability in the character, condition and quality of the stock) helps exacerbate other kinds of inequality. Thomas & Dorling (2004) have recently presented a vivid reminder of this, showing that between 1993 and 2003, the housing wealth of the ‘best off’ ten per cent of areas rose ten times more than that in the ‘worst off’ ten per cent. This spatial and socio-economic unevenness in capital gain (together with the risk of capital loss) might, moreover, be amplified with the advent of what Graham (in press) calls the ‘software sorting’ of societies. In housing, this is the process by which geographical information and

geodemographic systems increasingly shape the production and consumption of neighbourhood 'types'. This has considerable implications for the way people buy, sell and choose housing and therefore for housing market dynamics more generally (Burrows & Ellison, 2004). Certainly it raises the possibility that those who can will invest more in places whose past performance and current characteristics promise the highest rates of return. The scene is set for the 'investor figure' to eclipse the utility-seeking consumer and the home-finder in the market for owner occupation.

In short, the spread and accumulation of wealth through housing has enhanced the financial assets of a large proportion of British households over the last thirty years. This has slightly ameliorated wealth inequalities overall. But its effects are uneven across a range of dimensions. These socio-economic and generational differences in the acquisition, accumulation and loss of housing wealth, together with inequalities around race and gender, age and cohort, health and disability are currently less well attended to in British housing research than they once were. Moreover there is a risk that such inequalities will be amplified in the future in ways which are rarely documented and have yet to be fully understood.

ii) The fungibility of housing wealth

In addition to the growth in the size and value of the owned housing stock, the last decade has seen a steady increase in the options householders have to access their housing wealth.

Housing assets, like life assurance and pension schemes, were once primarily a resource for older age, but of late they have begun to diverge in character from these other assets. Pension funds, in particular, are not easily accessible before retirement in the UK; housing wealth, on the other hand, increasingly is. In the last five years, especially, there has been a frenzy of product innovation in the mortgage market, introducing a wide range of new options which allow borrowers unprecedented access to housing assets in a context where spend against secured loans does not have to be accounted for (but does, of course, have to be paid for). This, as Aoki et al. (2001) point out, is a key reason why house prices matter for the UK economy.

Among European countries, Britain pioneered the process of deregulation that increased the fungibility of housing wealth (Bridges et al., 2004), and the British public appear to have led the way in taking advantage of the opportunities it provides (HM Treasury, 2003). Even between 1979 and 1999 (ie before the most recent upturn in property values had fully established itself) overall mortgage equity withdrawal in the UK averaged three per cent of

³ In 1991, housing wealth accounted for 40% of all marketable wealth. By 2001 this (having dipped)

household disposable income. This stands in sharp contrast to the position in France, Germany and Italy where the net flow consisted of injections into housing equity averaging 6 per cent of household incomes.

There are two main ways to release housing equity: disposing of it (through sale, by trading down or selling an inheritance), or borrowing against it, using financial products as the interface. Although, in any one year, less than 6% of home owners release any funds at all by any of these mechanisms (this may be a conservative estimate), this rises to about a third among those who have moved or remortgaged in the last five years (according to the recent Survey of English Housing).

A distinction tends to be drawn in the literature (and in the character of financial products) between '*equity release*' in which the repayment of extracted funds is deferred until a property is sold (usually on death, or on transition to residential care), and '*equity withdrawal*', through loans paid back from an income stream over the lifetime of a mortgage. Equity release products (home reversion schemes or 'lifetime mortgages') are directed primarily to older home owners, and the growing potential of this market is clear (Terry & Leather, 2001); there is, after all, about £460bn of unmortgaged equity in homes owned by people over the age of 65 (J. Smith, 2004). However barely any of this wealth (less than .001 per cent) has so far been extracted, and equity release products account for just 0.3% of the mortgage market by value. This may well change in future, but for the moment it places the spotlight firmly on the different forms of equity withdrawal that allow home buyers to tap into housing wealth earlier in the life course, perhaps drawing on it repeatedly as it accumulates over time.

Trading down and last time sales are currently (and have historically been) the route by which the largest sums of equity are rolled out of housing, accounting for 60-64% of the total, by value (as measured in the Survey of English Housing for individual years (Benito & Power, 2004) as well as across a five year period to 2003 (Smith & Vass, 2004)). However by far the majority of equity extraction *events* consist of either overmortgaging (one in five events) and/or remortgaging or taking further advances against an existing mortgage (one in two equity extractions take this form). Both trading down and overmortgaging are facilitated by the relatively low costs and (correspondingly) high rate of housing transactions in Britain (only the Netherlands and Ireland have a higher rate of transactions as a proportion of their owner occupied stock, and no country for which data are available has lower transactions costs).

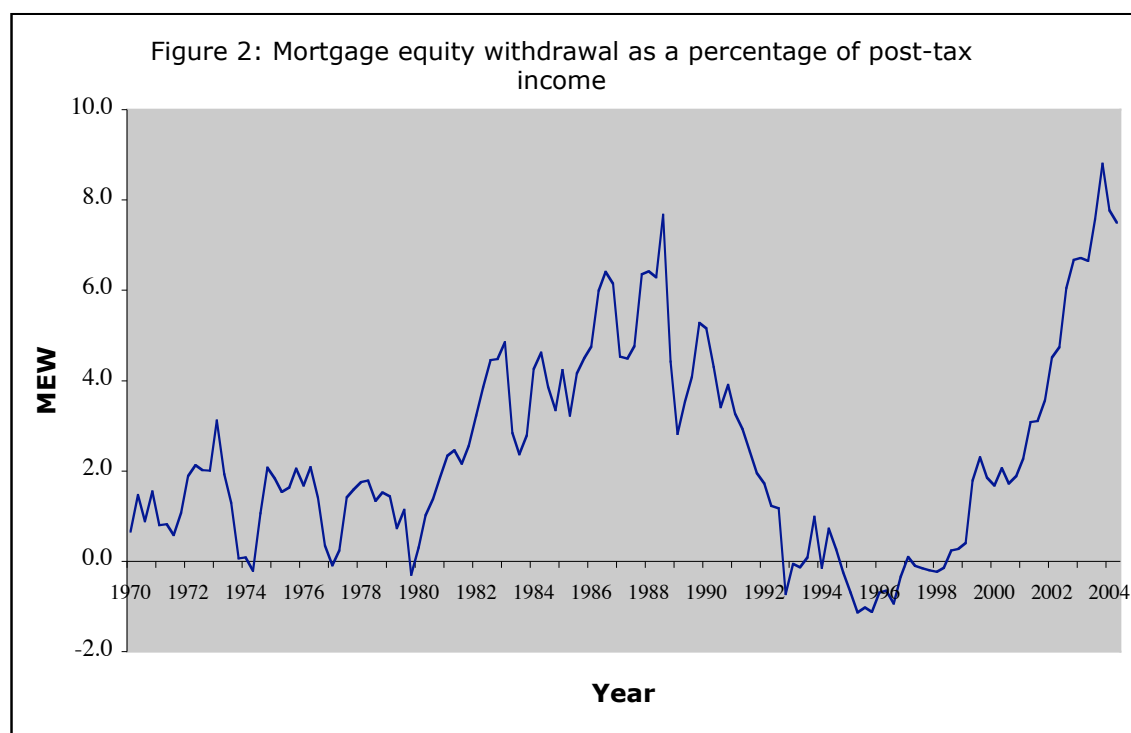
had climbed back to 36%, rising to 42% in 2001 (Social trends/ HM Treasury figures)

However, in the last five years an important new impetus for equity withdrawal has come from the introduction and enthusiastic take up of a new generation of flexible secured loans. These allow borrowers to tap into their housing wealth with relative ease, without having to sell and sometimes without incurring any other transaction cost at all.

Equity withdrawal is now possible with virtually any mortgage product in at least three ways. Overmortgaging (1), or remortgaging in situ (2), are the traditional routes; more recently flexible features (3) built into a wide range of products, and often packaged as ‘flexible’, ‘offset’ and ‘current account’ mortgages, have become much more common. These latter (flexible) products are particularly innovative in allowing funds to be as readily and routinely withdrawn from mortgages as invested into them (Duddleston, 2001; Smith et al., 2002). They radically lower the transactions costs (very broadly defined) of additional borrowing against housing equity, in ways which (Aoki et al., 2004) suggest tighten up the links between monetary policy and consumption. Most lenders now have some kind of flexible mortgage on their books, and flexibility is the second most frequently cited factor (after competitive interest rates) driving people’s choice of mortgage (CML Annual Mortgage Survey, 2003). (Intel, 2004) estimate that the proportion of consumers holding the most flexible of these products – ‘all in one’ mortgages – has risen from 1 per cent in 2001 to 6% in 2004, making these products ‘a major growth area within the mortgage sector’.

All this means that housing wealth is no longer a fixed asset; it is mobile in all kinds of ways. It can, for no more than the price of a phone call, or a visit to the cash machine, be spent on something as large as a new car or as small as a swimsuit. With nominal (though not real) interest rates reaching a 48-year low in 2003, and secured loans being so much cheaper than others, borrowing against the home has become an easy, obvious and cost-effective option for owner-occupiers to fund all kinds of spending. With estimates of unmortgaged housing equity now standing at £2.2 trillion, this is a significant resource. And while it might be handy for individual households, how it is used could have enormous significance for the economy. If all borrowers released as much equity as property values allowed, on the one hand, and as much as their incomes could sustain, on the other hand, consumer spending would increase dramatically, perhaps to the detriment of reinvestment in the housing infrastructure (see later). If, on the other hand, people put all their resources into paying off their mortgage, consumer spending could slump among those most responsible for making the high street thrive, and taxable savings would dwindle into non-existence. In the light of this, it is surprising how little information there is about households tendency or intention to tap into it their equity.

One useful data source is the Bank of England's estimates of Mortgage Equity Withdrawal (MEW).⁴ Trends in MEW between 1970 and q2 for 2004 (the latest figures available at the time of writing) are shown in figure 2.⁵



Low rates of MEW up to the early 1980s reflect the regulation and rationing of mortgage finance; negative figures in the early 1990s reflect falling house prices. At the other end of the scale, during the height of the rapid house price appreciation of the late 1980s, there were six, non consecutive, quarters during which MEW exceeded six per cent of post tax income amount UK borrowers. By mid 2004, in contrast, there had already been 8 consecutive quarters at this level, peaking at 8.8 in q3 for 2003, but still standing at 7.5 in q2 2004. In this latest phase, moreover, more than three times as much equity is routinely extracted as in the 1980s. From these aggregate figures, then, the indication is that MEW is more significant for UK households now than it has ever been before. Other useful quantitative estimates can be extracted from a variety of surveys (tapping into households self-reported behaviour rather than relying on aggregate figures). These are documented, for example, by (Benito & Power,

⁴ See www.bankofengland.co.uk/mfsd/mew/mew.htm

⁵ The Bank of England figures take the increase in housing finance (net mortgage lending and capital grants) and subtracts from this households' known investment in housing (purchases of new houses and houses from other sectors, improvements to property and the transactions costs of moving home).

2004; Davey & Earley, 2001; Ford et al., 2003; Smith and Vass, 2004; Smith et al., 2002). The broad generalisations are: that equity released through trading-down and last time sales may be saved rather than spent; and that while relatively modest sums, of around £20k are withdrawn at the point of remortgage or further advance, these sums are more likely to be spent than saved. Although these latter figures have been relatively stable in the past, the more prices (and underlying values) rise the more scope there is for the size of withdrawals to increase (Aoki et al., 2002).

What is most striking from this literature is: first, just how high the potential is for equity withdrawal to form a routine part of households' financial management; and second, how little is known about the way households approach these decisions, or about how they adjust their use of housing wealth to changes in the economy. Even less is known about the way different mortgage products, and related financial services, constrain and enable this process; or about how much people's changing relationship with housing wealth affects their demand for different kinds of mortgages and financial advice. Some of these questions are being examined in a new project on 'Banking on housing; spending the home' funded as part of the ESRCs 'Cultures of consumption' programme, and the FSAs new programme of research on financial capability may also fill some of the gaps. Nevertheless, there is some way to go to build a comprehensive evidence base for this aspect of home ownership.

iii) Changing political and social attitudes

The traditional wisdom around the asset value of housing is that it accumulates over the life course, provides a cushion (in the form of low housing costs) for old age, and flows on to the next generation through inheritance. This kind of investment is, from the perspective of households, primarily about spreading income across the life course. The average (median) household spends around 17 per cent of disposable income meeting housing costs. Home buyers, in contrast, spend 23% while they are borrowing, in return for a median outlay of 10% of disposable income once the mortgage has been repaid (ODPM live tables 901: household expenditure on housing 2002/3).

This traditional arrangement may, however, be changing. Politicians are now looking to housing wealth to meet a range of household expenditures, in particular to meet the costs of care in older age, and to supplement pensions. This view may also be spreading amongst householders. A recent qualitative study of older people's housing trajectories in Scotland suggests that older home owners bought their homes more by accident than as a speculative investment at a time when there was much less to choose between owning and renting (Power,

2004). None of the three cohorts of older owners who participated in this research engaged much with the asset value of their homes. However, a study across a wider age band by CML and Hanover Housing Association shows that nearly half the home owners in three age cohorts (aged from 45 to 80) expect to access some of the equity in their homes in retirement. Those in their 40s and 50s are much more likely hold this view than those who have already retired. Less than half of this (40-50 year old) group want to leave their whole house as an inheritance, compared with more than two-thirds of the older owners (J. Smith, 2004). This is consistent with Henley and Disney's ESRC-funded research which, by analysing the BHPS, showed that people under 40 in 1993 spent a larger proportion of the wealth they accumulated through housing between 1993 and 1999 than did those who were 55 and over.

Additionally, a variety of surveys of current mortgage holders suggest that flexibility is a sought-after quality in mortgage products. So far this flexibility has mainly been exploited in the tendency to overpay (cutting costs and reducing the term of the mortgage); but where home buyers are specifically asked about their strategy, their stated intention is generally to make more use in future of the possibility to borrow back. Lenders are increasingly offering these borrow-back facilities, and at least some groups of borrowers may be increasingly inclined to seize on this, spending their equity today rather than saving it for tomorrow (Smith et al, 2002). The evidence currently available (which is not as full as it could be) suggests that the scene is set for more, rather than less, use to be made of the opportunity to use housing equity across the lifecourse. It may not, for long, remain a resource for old age, much less a component of inheritance. Rather it may be viewed as a store of wealth which can be made available to spend on other things. What happens in practice depends of course on the wider economy and its regulation: on interest rates, house prices and policy interventions; and on the monitoring and management of risk.

Monitoring and managing risks

Housing provision in Britain is now 'marketised' in a number of ways. Owner occupation has become the tenure *de rigueur*, both through the 'commodification' of social renting and in the patterning of newbuild and reuse of stock. But the style of owner occupation is also, and increasingly, distinctive, in particular with regard to the way it is financed and securitised. So whereas a high proportion of the high rates of owner occupation in some Southern European countries are financed by family wealth, and whereas in some former Eastern bloc countries very high rates of owning resulted from the mass transfer of state assets into private hands, in

the UK (as in most of the English speaking world) households rely on a stream of financial services to fund and sustain owner occupation. This links households' money management (their strategies or behaviours around savings, spending and debt) directly into the world of international finance, fundamentally affecting the suite of risks to which households are exposed. This same shift in not just the extent but crucially the character of owner occupation also has macro-economic effects, so it has a bearing on systemic as well as individual risks and their management.

It is tempting to think about these risks in terms of a range of different possible futures for the housing economy: what happens to interest rates; whether supply constraints are relaxed; whether prices rise or fall; whether trends are stable or volatile. However, these scenarios are in themselves 'risk factors' which stem from, and feed into, other individual and systemic risks in complex ways. The next section is therefore organised around types or sources of risk. Where appropriate some suggestions are made about the different impact of these risks under different future scenarios. Although individual and systemic risks are intimately linked (Stephens (2004) has already made this point to the inquiry), they are considered separately here, not least because their causes and consequences are not always the same, and appropriate mitigation strategies are not necessarily compatible across these levels.

Banking on housing: individual risks

i) Exclusion and inequality

Owner occupied property is, for many households, their biggest store of wealth as well as their main source of expenditure. To the extent that housing performs well as an investment, there are disbenefits – including financial risks – to non-owners, as well as to owners who are unable to borrow against, or access the equity in, their property.

While the recent phase of house price inflation may have rewarded those already within the market, it has proved more exclusionary than the boom of the late 1980s. The Barker Review suggests that while 46% of new households could afford to buy in this earlier boom, by 2002 only 37% of new households could gain entry to the market. Vass's (2004) recent analysis similarly suggests that all aspects of affordability are beginning to worsen. Disbenefits to renters relative to buyers include: higher housing outlays (the UK is the only country among nineteen reviewed by Scanlon & Whitehead (2004) where private renting is more expensive for younger households than home purchase); and being unable to 'hide' savings in mortgage accounts to exempt them from tax and – in some case – to qualify for housing related

benefits. Incurring tax liabilities against savings when comparable owners might not is particularly ironic if renters are saving with a view to entering owner occupation.

There is also accumulating evidence that home buyers have access to a greater variety of sources of credit than renters. Exclusion from owner occupation compounds the risk of other kinds of financial exclusion because owner occupation weighs significantly in credit-scoring algorithms. Thus owner/buyers have better access than renters to higher levels of unsecured credit (such as credit cards). Bridges et al., (2004) show further that home ownership is used as a screening or signalling device for some kinds of credit but not others, thus affecting the portfolio of assets and the magnitude of debt in different tenure sectors as well as for different levels of housing wealth. In particular the unsecured borrowing available to renters might be more expensive and have less favourable (and more punitive) terms and conditions attached than that available to owners. The increasing 'software sorting' by location (Burrows and Ellison, 2004; Graham, 2004) is likely to make this more fine grained and increasingly neighbourhood specific, exacerbating inequalities within owner occupation as well as across tenure sectors.

As well as the risk of exclusion from home ownership, there are risks associated with the degree of inequality within that sector. Thomas and Dorling (2004) have put the spotlight on this in their report for the charity Shelter, showing, for example, that the ten per cent of children who (as a consequence of their parents' housing attainment) are the most housing-asset-rich have seven times more housing wealth at their disposal as the least wealthy ten per cent. There are other inequalities too. There is, for example, unevenness in practice in who, among owner-buyers, can and does borrow against their home. Cox et al., (2002) show that while indebtedness (relative to incomes) among the most indebted ten per cent of owner occupiers fell between 1995 and 2000, it did so against a background of increasing levels of (relatively costly) unsecured borrowing. This is in marked contrast to the least indebted 70 per cent, whose levels of indebtedness all increased and did so more noticeably (especially among the least indebted percentiles) through secured than unsecured loans. In short, those who are better off and have most housing wealth can borrow larger sums more cheaply.

Benito and Power (2004) also show (using data from the 2003 Survey of English Housing) that although equity withdrawal through last time sales and trading down is equally spread across income groups, borrowing against property (the commonest form of equity withdrawal, though it only accounts for about 40% of MEW by value) is concentrated among higher

income groups.⁶ Housing wealth can, in theory, facilitate access to reasonably priced credit for liquidity constrained households – flexible mortgages, for example, might provide some safety net for borrowers whose income stream is interrupted (Smith & Ford, 2002). However, this may currently be its least likely application. Housing wealth may, in the end, provide the best buffer against shocks in the economy to those households who least need it.

ii) Indebtedness

The flip side of speculating to accumulate in housing, or even of accessing housing wealth as a safety net, is the suite of risks associated with indebtedness. By 2001, 69% of British households were owner-occupiers, and in the decade 1992-2002 the debt required to finance this doubled (Mintel 2004) rising from 56% to 64% of GDP (Catte et al., 2004). Though other estimates are a little lower – around 60% of GDP – British mortgage debt is one of the highest in the developed world, exceeded only by Denmark (74%) and the Netherlands (79%). Not surprisingly, mortgages account for by far the majority of household debt in the UK, and rising property values (combined with sustained levels of employment) permit households to increase this as they go along (Aoki et al., 2002). As a result, owners are far more indebted than renters (May et al., 2004). Furthermore, aggregate levels of secured debt relative to income have tripled since 1980 (Hamilton 2003) and they rose from 95% to 125% of post-tax income in the five years to 2004 (Hancock and Wood, 2004). Mortgage debt now accounts for three quarters of UK households' total interest-bearing liabilities (HM Treasury, 2003).

Analysing the BHPS, Cox et al. (2002) show that, among mortgage holders, the most indebted households (by value of debt) are those with the highest gross assets (those with big mortgages have the most valuable homes). Because of this, in 2000 at least, positive net housing equity was more than sufficient to offset non-housing debts for most groups of households. The effectiveness of this safety net depends, of course, on home buyers being able to liquidise their assets if they need to, which is not always the case if unemployment rises and markets stagnate. Additionally, the widespread preference for variable rate loans in the UK (an average of 65% of mortgages held between 2000 and 2002 were of this type) makes borrowers here uniquely vulnerable to a change in short-term interest rates (Miles, 2004). Currently, it is this risk that dominates discussion. Employment in the UK is at an all-time high and for most (though not all) commentators, the outlook seems robust. Interest rates on the other hand are still relatively low (they averaged 5% between 2000 and 2004, in contrast to 7% in the 1990s and 11% in the 1970s and 1980s), though it is not clear whether and to what extent they might rise in the medium term. Even if they do, there may be some

⁶ Nearly 25% of owner occupying households earning over £40k have over-mortgaged, remortgaged

protective effect in the UK's medium loan-to-value lending rates, which typically approximate to the EU norm of 60-80%, even though 100% loans are available (HM Treasury, 2003).⁷ However even (perhaps especially) in a benign economic climate – even if unemployment and interest rates both stay low – highly indebted borrowers (in a setting where the average house price to earnings ratio is now 5.7, exceeding its 1980s peak) remain vulnerable to the financial consequences of biographical disruptions of all kind. These include relationship breakdown, ill-health and premature death of a mortgagor, against which, so far, neither state nor private safety nets offer a comprehensive protection package (Easterlow and Smith, 2004; Ford et al., 2003)

Moreover, as well as having loans secured against their home, owners have the possibility to engage in a wider range of unsecured borrowings than renters (and some mortgages come with an unsecured top up taking some borrowers over the 100% loan-to-value maximum). Owners are twice as likely as renters to have a credit or charge card, for example, and more likely to have borrowings against any cards they do have (Bridges et al., 2004). They are also more likely to have unsecured personal loans of other kinds. Home ownership thus enhances the possibility for households to acquire unsecured debt, and one of the risks this brings is 'debt overhang' – where total borrowings exceed the value of all assets, including those in housing – particularly if house prices remain volatile and property values fall. Since the probability of owing money on unsecured loans decreases as housing equity increases, the highest risks may be incurred by those who are already most indebted (people with lower incomes, or people who stretched themselves to make their most recent home purchase).

Although the debt to income ratio in the UK has increased dramatically since 2000, to reach over 130% by mid 2004 (Bank of England figures) the consensus in the literature is that, overall, the risks around indebtedness are not excessive. Neither Smith and Vass (2004) using the Survey of English Housing, nor Bridges et al. (2004) using the BHPS, nor May et al. (2004) reporting on a recent Bank of England survey, nor Hancock and Wood (2004) commenting on first time buyers, regard the risks associated with market entry, equity extraction or unsecured borrowing by home buyers as serious in the short term. All note that a small minority may be more at risk than others. On the whole, though, Bridges et al. show that while higher equity withdrawal between 1993 and 2001 is associated with increasing unsecured debt, this is only true to levels of about £27k, after which the association breaks

or secured a further advance, compared to just 3.5% of households earning less than £10k.

⁷ With a median in 2003 of 89% for first time buyers and 70% for movers (Scanlon, K. and Whitehead, C. (2004), *International trends in housing tenure and mortgage finance*, London, Council of Mortgage Lenders.).

down. They therefore attribute the majority of equity extraction to ‘consumption smoothing’ across the life course ‘which should not be a cause for concern’ (p. 39). Smith and Vass (2004), furthermore, expose a financial cushion in the housing wealth of the average home buyer which could withstand a fall of up to 10 per cent in house prices. This is reflected in the UKs historically low rates of possessions which, in the first half of 2004, were numerically at their lowest since 1982, and lowest since 1973 when measured as a proportion of all mortgages (CML, 2004). More recent figures are slightly more circumspect, flagging a small increase in arrears which might feed a modest upturn in possessions (CML, 2005). Thinking ahead ten years, however, it seems unlikely that the climate for home ownership can continue to improve. In which case households with all their financial eggs in the property basket may find themselves at risk.

iii) Narrow investment portfolio

Risk in relation to home ownership is usually thought of in terms of the probabilities of possession as a consequence of over-indebtedness. The risks of low returns on housing investments – the pitfalls of concentrating wealth into an asset which performs badly – are less well appreciated (outside the rather specific case of capital loss and negative equity after the 1980s boom). However, Britain is distinctive in the high proportion of personal wealth – 62% – which is concentrated in homes (Banks et al., 2002). The notorious volatility of house prices (discussed below as a systemic risk) may therefore impact on individuals by increasing investment risk in the short and medium terms, even if housing wealth accumulates steadily in the long term (a prediction which itself presumes no overall shift to a deflationary environment).

In other settings (notably the USA, where only a third of household wealth is held as home equity) explanations for such concentration as does occur are usually the flip side of explanations for low rates of investment in stocks and shares (e.g. Frantantoni, 1998). Such accounts tend to suggest that one risky investment (housing) is as much as most households can bear. In Britain, however, the concentration of investment into owner-occupation may have a rather different explanation. The Association of British Insurer’s (2003) review of the state of the nation’s savings suggests that people invest in domestic property because they view it as a reliable store of wealth. Research commissioned by the Financial Services Authority also consistently suggests that consumers believe domestic property to be a relatively risk-free investment, with a good rate of return. Although the high volatility in British house prices may not entirely support this view, its popular tenacity may explain Banks et al’s (2004) contention that owner occupied housing is an exception to the ‘rule’ that

risk averse individuals avoid risky assets as price volatility increases (some other explanations are considered by Nordvik, 2001).

One effect of volatility, in fact, may be to accelerate the entry of first time buyers into the market (as a hedge against future prices rises or exclusion). This partly accounts for the relatively high (if declining) rates of owner occupation among younger age groups in Britain compared, for example, to the USA (Banks et al., 2002).⁸ One benefit of early entry is getting onto the housing ladder at all (and potentially accumulating wealth as prices rise); a disbenefit is the lack of funds to invest elsewhere. This may include an aversion to funding social goods, which in turn could have knock on effects into public support for welfare expenditure. Schmidt (1989), for example, found a negative correlation between rates of home ownership and national spending on social protection, and Boelhouwer et al. (2004) suggest that buyers cannot sustain both their housing costs and the high rates of taxation that a welfare economy demands. Ironically, while low social protection may be one consequence of high house prices, it may also fuel price rises as people turn to housing investment to create a personal safety net knowing that collective measures are on the wane.

Whatever the social implications, it is clear that financially there is only one other private investment, in addition to home purchase, for the average British household: their pension. Although the impact of poor stock market performance on pension funds has turned political and public attention to housing wealth as way of funding retirement, a recent CML/ Hanover Housing Association study finds no evidence so far of a wholesale shift of investment from pensions into property. There is, however, a greater tendency among younger cohorts of working owners to say they will rely on property as both a main and a second source of retirement income (J. Smith 2004). This 'funds for retirement' use of housing wealth is consistent with Benito and Power's (2004) analysis of the Survey of English Housing which indicates that the largest stream of released equity (extracted through trading down and last time sales) is more likely to be saved for the future than spent. Certainly among the younger age groups in J. Smith's (2004) analysis, property/home equity is identified more often than other investments (apart from routine savings) as being important for funding older age.

Over the next two decades, rates of owner occupation may increase among the over-65s in Britain from around 65 per cent to as much as 80 per cent. Since outright owners have a

⁸ Rates of home purchase are more than ten per cent higher among 20-39 years olds in Britain than in the USA (Banks, J., Blundell, R., Oldfield, Z. and Smith, J.P. (2004), 'Housing wealth over the life cycle in the presence of house price volatility', *National Bureau of Economic Research*, Cambridge, Massachusetts.).

virtual income stream from housing it might reasonably be suggested that older owners can manage on smaller pensions. Indeed there may be evidence across EU member states that accumulating housing wealth has effectively funded a wave of early retirement (Doling and Horsewood, 2003). However, whether and to what extent housing wealth can reliably be regarded as a retirement fund depends: first, on house prices reliably keeping pace with inflation; and second on the extent to which housing equity has already been mined to fund other things⁹. British households have a wide range of risks to manage with the wealth they have, and few of these risks can be deferred to older age. These risks include: loss of income through illness or unemployment (this is the most frequently cited risk of owning among mortgage holders interviewed in the Mori Financial Survey for 2003) or through relationship breakdown; increased outgoings demanded by interest rate rises, the costs of maintenance, repair and insurance, the expense of living with illness, and others.

Ironically, just as the fact of being an owner enhances access to some kinds of credit in the marketplace, so it may diminish access to some kinds of social benefit. There is a separate paper in this series on the implications of owning for access to a range of means-tested (and other) benefits. However, to the extent that owner-buyers are made dependent on the market to meet a range of welfare needs, it might be argued that the typical British household, and certainly the average owner-occupier, has a too-narrow investment portfolio. Even ordinary savings rates are low in the UK compared to the rest of Europe, and declining. From a high of 10% of post-tax income in 1990, savings rates fell to 4% by mid-2000 (Davey, 2001) so that British households save at less than half the rate of their French counterparts (though this is still nearly twice the rate of US citizens).

Some analysts argue that concentrating wealth into housing is a wise strategy; that it is more profitable and less risky than investing in portfolios consisting only of monetary assets (see Wullkopf 2002). And there is an extent to which the narrowness of home buyers' investment portfolio in the UK has paid off. Over the long term, HM treasury (2003) estimates that there is a real rise in house prices of about 2.5% per year; and in the last decade housing has performed especially well as an investment. Iacoviello and Ortalo-Magné (2003) illustrate this using London as an example. Here, they argue, even households with limited wealth are better off owning their home than they would be by renting and investing in other assets, *as long as they are willing to face the financial risk involved*. And these risks do exist (even in the context of an overall appreciating market) and are unevenly spread. Henley (1999) for

⁹ It also depends on the viability of equity release products which are commercially attractive without putting older households at risk; a challenge considered by **Terry, R. and Leather, P.** (2001), *The*

example challenges the idea that the 1980s boom produced a big redistribution of wealth to the middle aged in SE England. He makes the point that there were winners and losers across the board (see also Hamnett, 1999). Likewise, Disney et al. (2002) show that although the average home owner made a real housing gain of over £20k between 1993 and 1999, almost one in six owners experienced a real fall in their housing assets in this period. This kind of inequality has prompted Iacoviello and Ortalo-Magné (2003) to argue that poorer (as well as better off) homeowners could reduce their exposure to this kind of risk if they were given access to housing price derivatives.

On the other hand, between their peak in 1989 and the bottom of the most recent recession in 1994, average house prices fell by 30%, wiping out over £33 billion of housing wealth (Henley & Disney, n.d). A fall of this magnitude casts real doubt over the extent to which the asset value of home ownership can consistently or reliably be harnessed to welfare ends. The unequal effects of such volatility also questions the idea that widespread housing wealth reduces the need for some kinds of social protection. This raises important questions (which are taken up later) not just over what proportion of households, and the nation's wealth, is invested in housing, but how much *should* be allowed to accumulate there.

One of the most rehearsed aspects of the asset value of home ownership revolves around the distinction between consumption and investment issues (especially for policy purposes). It is usually argued the favourable tax treatment of owner occupation reflects its positioning as a consumption rather than an investment good (so there are no capital gains or imputed rents for primary residences). However, it could equally be argued that the way housing is treated for taxation purposes (gains are not taxed, losses are not recoverable against tax) is neither about consumption nor investment, but rather about the profit and loss in gambling. One of the few recent qualitative studies of housing transactions in the UK shows that in the experience of buyers and sellers, and, to some extent, in that of professional intermediaries, housing gains are more like winning the lottery than accruing interest on savings or dividends on shares. The findings of this research redefine 'bubbles of speculation' as an economy of desperation and show just how random the gains and losses of housing investment are from a householders' perspective (see Smith, 2005; Smith et al. forthcoming). Buyers themselves use gambling metaphors to account for their purchase: no wonder bookmakers are finding a market for spread-betting on housing, encouraging gamblers to 'profit from market volatility, or hedge the value of your own property'.

The rise and rise of owner occupation: systemic risks

i) *Volatility*

Recently, ‘volatility’ has become more of a buzz-word than ‘sustainability’ in the housing policy community. House prices are surprisingly and notoriously volatile, especially in the UK, which is one of only four OECD countries (with Italy, Spain and Finland) whose standard deviation of annual percentage changes in house prices between 1971 and 2002 exceeded ten per cent (Catte et al., 2004).¹⁰ Banks et al. (2004) argue that volatility increases demand, and feeds itself, as buyers who might have rented are prompted to enter the market in a setting where ‘insuring [against] the risk of house price rises is more important than avoiding the risk of a house price fall’ (p. 9). One result is that prices are higher overall in the most volatile markets, with the consequence that younger households may be drawn into buying earlier, and into larger properties (presumably with higher levels of debt), than they otherwise would.

But higher prices overall is not the only, or even the main, risk associated with volatility. Housing markets have an important economic role and although (as noted earlier) volatility may be risky for individuals, it is also problematic at a systemic level because of its interaction with broader aspects of economic management: its impact on financial sector soundness, its implications for labour markets and its consequences for consumer protection in the mortgage market (Hilbers et al., 2001; Laslett et al., 2001). Price volatility influences the speed and magnitude with which monetary policy responses to ‘shocks’ are transmitted through economies and it has the potential to create macroeconomic imbalances. HM Treasury (2003) is therefore concerned that any instability in housing markets may be translated into instability in economic activity more generally, and Barker (2004) argues that this has already created problems both for business and economic policy makers.¹¹

There is some debate around the particularity of UK house price volatility, but there is little doubt that it is on the high side of average. Moreover, while a number of European countries experience substantial volatility in prices, these cycles do not appear to be synchronised (HM Treasury, 2003). So it is likely that local (national) factors have a key role to play. In the UK

¹⁰ Though puzzlingly, using data labelled ‘average percentage deviation of real house price from trend 1970-2001’ for eleven European countries, Bridges et al. (2004) only identifies France as having levels less than 10 per cent. This measure is highest in the Netherlands (25%) with the UK in the middle (15%). See **Bridges, S., Disney, R. and Henley, A.** (2004), ‘Housing wealth and the accumulation of financial debt: evidence from UK households’, in Bertola, G., Disney, R. and Grant, C. (eds.), *The economics of consumer credit*, Cambridge, Massachusetts, MIT Press.

¹¹ Barrell et al. (2003) are more cautious, arguing that the impact of a ten per cent fall in house prices today would have fewer systemic effects than they did in 1989.

policy arena the favoured explanations for price volatility currently hinge around housing supply issues, on the one hand, and the nature of the mortgage market, on the other. These are dealt with, respectively, in the Barker and Miles reviews, so only a brief note is required here.

On the question of supply, the distinctively low responsiveness of housing supply to demand in the UK is a critical issue (HM Treasury, 2003; Barker, 2004). Low levels of investment in housing supply may fuel house price cycles as people buy earlier and pay more as a hedge against exclusion. Although enhancing supply is unlikely to be a cure-all for price volatility, attending to supply issues has a sufficiently wide range of additional social, as well as economic, benefits to place it high on the policy agenda for the medium term.

Volatility may also be rooted in the mortgage environment. As many as 60% of UK mortgages are interest-sensitive variable rate loans; no other European country matches this – Italy comes closest with 35%. This may have knock on effects into price fluctuations, and it also means that households' disposable incomes, as well as their ability to service debts, are over-exposed to interest rate variations. Whether this reliance on variable rate (as well as short term fixed rate) mortgages feeds into price volatility overall is less certain: a comparative analysis of the UK and the Netherlands (where longer term fixed rate mortgages are more common) finds little to support this (HM treasury, 2003). Nevertheless, Miles (2004) argues that if borrowers could be persuaded to look to the medium term risks that are associated with variable rate loans (rather than to immediate housing outlays) they might choose longer term fixed rates, and this might reduce volatility. [Though this neat formula may overlook the extent to which it is the longer term savings in interest payments that often attract households to flexible variable rate mortgages, even though the short term cost might be a slightly higher interest rate]

There are, of course, other factors encouraging price volatility. Muellbauer and Murphy (1997) attribute volatility to high gearing permitted by lenders, low transactions costs, and a history of positive investment returns. Reflecting on the strong growth in MEW in the 1980s Westaway (1993) argues that this was fuelled by a stream of 'quasi-consumer credit' which itself made the housing market more volatile than it might otherwise have been. Westaway thus attributes price volatility to credit-based effects which might merit more attention than they so far have in the current economic and policy environment. Whatever the cause, there is a general consensus that price volatility is a key systemic risk even though (and perhaps because) it is difficult to account for and even harder to predict.

ii) *Sustainability*

The expansion of owner occupation in the UK has been achieved primarily by a shift ‘downmarket’: people who once looked to renting on account of both their incomes and their other housing (especially health-related) needs are now home buyers (Smith et al., 2004). Boelhouwer et al. (2004) have argued that this movement into the market of households whose incomes are relatively low, and whose only financial asset is their home, may make sustainable housing markets hard to achieve. Relying on lower income groups to maintain high levels of home ownership, especially against a background of steadily rising prices, is certainly risky for a national housing policy founded on the growth of sustainable owner occupation.

A range of issues around sustainability which are pertinent to this enquiry have already been set out by Meen (2004), who identifies and elaborates on the many dimensions of this term. There is also a fairly well established literature on the (limits to) sustainability for owner occupation which probably does not need restating here. One further issue for this enquiry, however, is the extent to which strategies to promote sustainability of any kind can work in a policy environment which increasingly discriminates between owners and renters. This is, after all, a time when – among lower income groups at least – the socio-economic and housing needs profiles of owners and renters are increasingly similar. Donna Easterlow and I have reviewed this policy disjunction elsewhere, in relation to the project of housing for health, and in terms of social welfare more generally (Easterlow & Smith, 2004; Smith & Easterlow, 2004). We draw attention especially to the very different demands made on, and requirements extracted from, the providers of social and of private housing. We question the government’s presumption that, because owned housing is an asset, the responsibility for maintaining this asset (its quality, condition and repair) is an individual rather than a collective obligation. There are risks here both for the longer term environmental quality of the owner occupied housing stock (which is taken up later) and for the more immediate affordability of owner occupation.

iii) *Bonanza! Or, the dematerialisation of housing equity*

During the housing bonanza of the 1980s local authorities cashed in as the sale of council housing netted more than all the other early eighties privatisations put together. This in itself is a useful reminder of the extent to which the asset value of owned homes, while it may be increasingly privatised, individualised and economised, is also a major national, collective and social resource. Owned housing may be an investment and an asset for households, but it

is also – and increasingly – relied on to fulfill a range of human needs and provide a stream of services that are important for social welfare. Perhaps the major systemic risk associated with the future of home ownership is the risk of failing to strike a balance between these functions for the housing stock. This may be thought of as the risk of another kind of ‘bonanza’ – a one-off diversion of housing wealth not from the state to the market but from the housing stock into other things.

There has always been some concern about the possibility of housing equity ‘leaking’ into other areas of the economy. Prior to the financial deregulations of the 1980s this was a minor consideration, not least because it formed a tiny proportion of personal disposable income. What concern there was at this time centred on the extent to which it might constrain housing market activity (Westaway, 1993).

Before the termination of MIRAS there was also discussion about the dangers of giving tax-relief to non-housing expenditure fuelled by mortgage finance (a benefit which might, for example, have encouraged overmortgaging to fund other kind of spending). While this particular risk may have been addressed with the phasing out of MIRAS, there is surprisingly little attention given by the Treasury, or by other government departments, to other inconsistencies in the treatment of housing investments. These include exemption from tax on savings for those whose debt is in the form of a mortgage (as mortgages and savings accounts become effectively indistinguishable across a wide range of products) and eligibility for means-tested benefits such as ISMI which can, theoretically, be achieved (where earned incomes are sufficiently low) by ‘hiding’ savings in mortgage accounts (Smith and Ford, 2003). Even less concern is evinced over the extent to which established home buyers, amazed by the way their properties have appreciated in value, may have turned to mortgage borrowing to service other debts, meet welfare needs, or fulfill consumption desires. Perhaps this does not matter. The systemic risk, however, is that there is more potential now than there has ever been before to divert equity out of the housing stock into places – beyond as well as within the UK – where it can no longer be used maintain the quality, condition and future standards of owner occupation.

It is, of course, still early days to be judging the effects of the flexible mortgage products which encourage households routinely to roll money in and out of their property. Economists remain largely locked into the discovery that, notwithstanding the rational assumptions built into Franco Modigliani’s ‘life cycle hypothesis of saving’, households continue to store up their assets into older age, rather than running them down towards the end of their life. This

tendency has, of course, been particularly marked in relation to housing assets, which have traditionally been fixed, and have formed the major component of most home buyers' legacy to the next generation. But at a time when even governments are looking to housing wealth not only as an insurance policy for later life, but for other kinds of securities, there may be a case for attending more carefully to the question of what happens to the considerable amount of housing equity that can be withdrawn, even as it accumulates, across the life course. One possibility here is that far from being concerned about such 'leakage' governments may be forced to encourage it, in order to stimulate demand in economies that can no longer rely on boosting social wages to achieve this end.

Economic analysts often find it difficult to account for the translation of housing wealth into consumer behaviour (Lantz & Sate, 2001). While some data suggest that a growing proportion of consumer spending is fuelled by housing equity (Aoki et al., 2002; Boone et al., 2001), other estimates are less clear cut (Benito and Power, 2004), and some analyses suggest that price volatility *discourages* refinancing to fund non-housing consumption (Banks et al., 2004). Nevertheless, there is a strong theoretical case to support the argument that the deregulation of the financial sectors of most OECD countries has led to a rapid expansion of credit and that this has eased households' liquidity constraints and boosted consumption above the levels expected from incomes alone. There is, moreover, some evidence to suggest that this is particularly true for the UK.

Britain has always been a place where buoyant housing markets and high street spending go hand in hand (Hamnett, 1999), and there is a close relationship between house prices and consumption of durable goods (Aoki et al., 2002). Indeed, the UK shows the strongest correlation between private consumption growth and real house price changes of any OECD country between 1970 and 2002; and it is one of just four OECD countries which show a long run relationship between equity withdrawal and consumption (Girouard & Blondal, 2001). It is one of five countries (with Australia, Canada, the Netherlands and the US) where housing wealth effects on consumption exceed those of financial wealth effects, and it is unique in exhibiting the effects across the short as well as long run (Boone et al., 2001). This same study shows that the 'housing wealth effect' is entirely accounted for (statistically at any rate) by housing equity withdrawal. It is not, therefore, surprising that a recent round up of evidence by HM Treasury (2003) suggests that the sensitivity of household spending to house prices and housing wealth is higher in the UK than elsewhere. Even in the past, when such wealth was generally notional ('you have to live somewhere'), consumer spending tended to increase with the belief that house prices are appreciating (MacLennan & Tu, 1998). However,

the increased fungibility of housing wealth means not only that people may *feel* richer in a period of house price appreciation, but that they can readily roll their capital gain out of housing and into other things. And, whereas until quite recently, the main trigger for such ‘rolling-out’ was residential mobility, the rise of in situ refinancing and flexible mortgages, means that this need no longer be a significant constraint.

There is undoubtedly a wide range of financial and material benefits (as well as risks) to home buyers in all this. But there are some notable systemic risks too. One is that this level of spending against housing equity is to an extent a one-off. Even if property prices appreciate over time, some heroic assumptions would be needed to allow their asset value both to be drawn on today to provide a safety net against unemployment, or to fund education or boost high street consumption, and relied on tomorrow to supplement pensions or fund health and social care. A second risk is that so much flexibility in how housing wealth is spent may come at the expense of reinvestment in the housing stock.

The government is clear that the responsibility for maintaining the quality and condition of the owned housing stock rests with individual households, precisely because owned homes are a financial asset as well as a housing service. The general consensus, however, is that only about half the gross equity release from housing is reinvested in the stock. This is confirmed in recent analyses based on the SEH (Benito and Power, 2004), who found that half those who withdrew equity spent it on home improvements.

There is a tendency to view this figure with some satisfaction: as much as half the flow of equity out of housing is reinvested into the stock. But this means that at least half (and probably more where the most flexible mortgages are concerned¹²), flows into other things. And there is at the moment no clear sense of whether or not this matters. There are no targets set for reinvestment, no warnings or guidelines issued to householders about how to spend their housing wealth, and – especially when prices are rising rapidly – no effective penalties in the housing market for failing to keep the property up to scratch. ‘Quality, condition, repair’ does not have the same ring as ‘location, location, location’ in the world of estate agency. The advent of sellers packs is unlikely to change this substantially (though it will at least raise sellers’ awareness of what they may need to attend to prior to moving on),

¹² Among those interviewed in a recent survey of flexible mortgage holders – i.e. among borrowers choosing the kind of mortgage designed to make equity release easier – only one in three of those who withdrew any equity spent it on their home. Two thirds used it to service other debts or to buy treats and luxuries. See **Smith, S.J., Ford, J. and Munro, M.** (2002), *A review of flexible mortgages*, London, Council of Mortgage Lenders..

especially in a ‘changing rooms’ culture whose signifiers for adding value rarely connect with the kind of investment needed to safeguard and regenerate the stock¹³.

And what of the fifty per cent of equity that is, apparently, reinvested? Nearly all our knowledge of this comes either from gross estimates based on aggregate figures, or from a relatively small amount of questionnaire survey data in which, at best, spend on home repairs, renovations and extensions are one of half a dozen ‘tick box’ responses. Notwithstanding the important work completed by Phil Leather, Moira Munro and others in the ESRC beliefs and behaviours programme there is nothing of note in the literature concerning householders’ knowledge, capabilities, and inclinations to use housing wealth to secure the long term quality and condition of their home.

The point here is that, whether as a means of funding consumption preferences, or as a way to meet key financial needs, the accumulation of wealth through owner occupation has the potential to allow significant leakage of housing equity out of the housing infrastructure and into other areas. People have an incentive to grow the market – to build up their housing wealth – precisely because of this. This is partly why the price of housing in the UK is so high.¹⁴ As a consequence, however, the whole system may lean towards short term revenue rather than long-run regeneration; towards individual financial gain and individual risk mitigation rather than towards social or environmental sustainability. The wider range of concerns this raises are set out in (S. Smith, 2004). A key question is whether from a systemic perspective it is wise to encourage or allow so much personal wealth to be invested in housing. Once there it certainly cannot, in the current policy environment at least, be guaranteed to be used in the way policy makers anticipate or hope.

¹³ For example property programmers identified ‘GLAMS’ (gorgeous lifestyle accessory must-haves, such as espresso machines and plasma TV screens) as third in the top ‘Twenty quickest ways to make money on your property’ (Channel 5, 5.11.2004). Installing appropriate GLAMS can, they claim, add as much as £15k to the sale price of the average home. This is nearly three times as much as the gain from adding a WC, twice as much as from installing a new kitchen, and a third more than the value added by painting and cleaning!

¹⁴ **Banks, J., Blundell, R. and Smith, J.P.** (2002), ‘Wealth portfolios in the UK and the US’, *NBER Working Papers*, Cambridge, Massachusetts., for example, show that even in the mid 1990s, the median value of a home in the UK exceeded that in the US by as much as 14%.

Mitigating risk

The way the owner occupied housing market currently works undoubtedly has benefits for individuals and for the economy, but it also has the potential both to unsettle wider economic trends, and to expose vulnerable households disproportionately to the effects of this. While it is tempting to assume that strategies to mitigate systemic and individual risk are one and the same, this is not necessarily the case, particularly given the dominant wisdom about how global markets and local housing systems work. There are, of course, some common building blocks: boosting inclusion (growing the market overall and widening its wealth effects); dampening volatility (stabilising the economy and enhancing equity in the distribution of housing gains and losses); managing indebtedness (securing the viability of lending, as well as the wellbeing of households); and safeguarding the future of the housing stock (protecting households' investments and securing a viable housing service for UK residents). However, while systemic risks within the prevailing political economy may best be tackled by one model of risk-mitigation (incremental, evolutionary change in the interests of better business as usual), an adequate response to the changing nature, magnitude, and consequences of individual or household risks might demand a rather different approach. Reconciling these models could change the nature of owner occupation in some quite fundamental ways.

i) Business as usual: the evolutionary approach

The 'business as usual' strategy for minimising the risks of owner occupation assumes that the building blocks for an affordable, sustainable housing market are in place. What is needed, if anything, is for financial consumers to 'catch up' with the implications of deregulation, and in particular to improve their financial literacy and capabilities in order to keep pace with the growing range and diversity of financial services available to them.

This view certainly seems reasonable from a mortgage market perspective. The UK (together with Denmark and the Netherlands) has one of the most 'complete' mortgage markets in Europe, judged by the variety of products on offer, the range of borrowers served and low mortgage interest rate spreads (Catte et al., 2004). According to the Council of Mortgage Lenders, taking into account the accessibility of mortgage finance and the availability of information and advice, the UK tops the completeness table (Anderson, 2004). David Miles' (2004) review of the UK mortgage market thus refers tellingly to its strengths, and finds no evidence that it is deeply flawed. There is indeed a general consensus summed up by Laslett et al (2001) that: 'the mortgage market as a whole is mature, liberalised and stable'; what policy concerns there are thus form a patchwork around the difficulties facing 'some classes

of borrower' (p. 22). Thus it is that half of David Miles' recommendations focus on ways to improve the advice and information that borrowers receive, and on the importance of creating a fairer more transparent pricing structure to enable borrowers more effectively to judge the costs and risks of different mortgage products. Even then, the aim is to ensure that any changes 'reflect the current best practice of lenders and financial advisers' (p. 3). The main issue, it seems, is how to share this existing expertise across the market place. The reasoning underpinning this is that 'Monetary policy will be easier to manage if households make well-informed decisions about mortgage products that are priced in a transparent and sustainable way and where the risks of different types of mortgage are well-understood' (p. 4).

So one strategy is to use incremental change to make the market as it is work better. Such strategies, according to Laslett et al. (2001) 'must not impede the functioning of markets' and 'should be targetted on specific goals of preventing speculative bubbles, achieving greater regional price stabilisation and protecting vulnerable borrowers' (p. v). To achieve this, these authors, like Miles, place considerable emphasis on information disclosure and consumer education. This same impetus lies behind the Financial Service Authority's drive to document and enhance the public's financial capabilities now that it has responsibility for the regulation of mortgage as well as insurance products.

This 'knowledge plus capabilities approach' does not, of course, directly or entirely address recent declines in the overall affordability of owner occupation (Vass, 2004), although this is tackled to some extent in Miles' (2004) second group of recommendations. These outline ways to reduce the costs to lenders of managing risk, enabling them to offer a wider range of lower interest rate, longer fixed term, mortgages. This would, Miles argues, both boost affordability and enhance the sustainability of home purchase. If combined with greater accessibility to, and use of, the range of mortgage payment protection products now on the market, this might be regarded as a constructive way to minimise the risks and maximise the benefits of owner occupation over the short, medium and longer terms. What this line of reasoning draws attention to in particular is the importance of state guarantees in risk mitigation in the mortgage market. Interestingly, these guarantees generally protect lenders rather than borrowers, ostensibly to encourage them to lend to higher risk groups. Lenders servicing the highest risk groups – the subprime market – may additionally be protected by a process of securitisation, which effectively transfers the risk to investors.

The 'evolutionary' model of risk mitigation is a two pronged strategy whose success hinges on educating borrowers (to enhance their financial skills) and protecting lenders within a

framework of 'fair and responsible' lending. This all seems reasonable: a necessary part of reform. But it may not provide a *sufficient* framework for mitigating risks, for at least two sets of reasons.

First, the capabilities approach to financial services seems at odds with a wider literature on consumption: the same home buyers are regarded as 'duped debtors' on the one hand and competent, calculating, customers on the other. Undoubtedly it is less interesting to most buyers to follow the small print on a mortgage application than it is to follow the instructions to link their read/write DVD player to a plasma screen tv without upsetting its internet connection. But is it that much more difficult? There is certainly a role for consumer protection whether new technologies, durable goods or financial products are up for sale. The mortgage maze is as complex as any, and more challenging than many, product ranges, and it may well be due for a consumer-friendly overhaul. But it seems unlikely that ignorance, incompetence or inadequacy is the sole, or even the main, reason why borrowers are at risk; and it may be equally unlikely that education or capability enhancement is a sufficient route to mitigation. Certainly there are other policy arenas (health education, accident prevention, environmental management, for example) in which this strategy has been tried and found wanting (see, for example, Roberts et al., 1995). Lay knowledge usually proves to be more extensive and sophisticated than educators expect. Equally, recent work in economic psychology – and in other disciplines too – indicates just how complex the link between knowledge and behaviour can be.

Second, it is possible that the nature of the risks facing British owner/buyers has changed qualitatively as well as quantitatively in the last quarter century, demanding radical rather than incremental approaches to risk mitigation. Mortgage markets may be nationally inclined but the viability of lending institutions is increasingly tied into international finance and there are limits to what states can do to manage this. On the other hand there may be more options than governments typically recognise for states to protect social welfare even as households' strategies for managing savings and debts are themselves exposed to the vagaries of the international economy (see Smith and Easterlow, 2004 for some ideas). Certainly there may be scope to develop more direct measures to mitigate the risks to individuals; supporting households might be as big a boost to lending as protecting lenders from risky individuals. There is a case too that some of these measures might be implemented by an alliance of business interests and state institutions: that more might realistically be asked of 'the market' without jeopardising the economy.

Third, a particular form of owner occupation accommodates most people in the English-speaking world. How this element of the housing market works is generally taken for granted; attention is paid to what it achieves for owners (on the one hand) and to the challenge of mitigating its uneven and unequal effects (on the other). When market failure seems to have no market solution the social sector is brought into play. The possibility that ‘the market’ for homes might be different in any fundamental way – that the bottom line for markets may be defined ethically and socially as well as financially, for example – is therefore rarely entertained. Yet, while a certain inertia on these points might be expected among politicians and policy makers, it is increasingly hard to justify in the research community. Here, the question of what markets are and how they work is coming under its most intense scrutiny for nearly a hundred years. Mitigating the risks traditionally associated with owner occupation takes an interesting turn when it is tied to a more wide-ranging rethink of markets of all kinds, and of housing markets in particular (a point I have tried to develop in Smith, 2005).

ii) Towards a care-full market?

It is traditional in policy circles to distinguish the role of markets ‘which work’ as price driven distributive mechanisms, from the interventions of a state ‘which cares’ for those whose needs cannot be catered to commercially at prices they can afford. This distinction is more than evident in British housing policy, where the government has recently been active in promoting welfare-orientated housing environments in the relatively small social rented sector, while using the mantra ‘market solutions to market failures’ to inform policies for the private sector. More thought-provoking still is the attempt to introduce some of the most appealing aspects of market provisioning to social tenants (choice based lettings, for example as well equity shares). Reviewing these trends, Donna Easterlow and I have made the following point:

‘It is striking that no attempt has been made to bridge the tenure divide in the other direction; none of the merits of distributing resources according to need have been transferred into the private sector... Rather than extending an ethos of care by infusing the institutions of the market with some demonstrably effective social practices, it could be argued that these policies are transferring a competitive individualism from the market into spaces once celebrated for their social concern’ (2004 p. 1013)

There may, nevertheless, be a case for challenging this trend; for mitigating the risks of home ownership precisely by drawing from Britain’s unique store of experience in using housing interventions to meet social aims and applying it to the world of owner occupation. Certainly

it may be worth considering whether housing policy asks and expects too little of ‘the market’ precisely because its sphere of operation and *modus vivendi* is too often taken for granted.

One option is to boost inclusion in (and thereby to redefine the nature of) ‘home ownership’ through a more flexible and less discriminatory approach to tenure. An ESRC funded study of housing for health, focussing on the home ownership experiences of people experiencing ill-health, called for greater flexibility in housing tenure, enabling renters to become part-owners and owners to become part-renters as needs and circumstances change (Smith and Easterlow, 2002, 2004). The idea of introducing a sliding scale of equity shares and promoting the development of intermediate tenures is currently under consideration by the council of mortgage lenders, as are a range of other schemes for improving flexibility in housing markets (Hoyle, 2004). These could usefully draw from Britain’s growing experience of shared ownership, rent-to-mortgage and mortgage-to-rent schemes (see also Bramley, 2004). This flexibility might be used to allow a wider range of households to benefit from the wealth effect of owner occupation, but it might also be developed to allow home buyers access to the welfare protections that are routinely built into social renting.

On the one hand, this would require a rethink of how mortgage lending works. Daphnis & Ferguson (2004) draw attention to the poor fit between traditional mortgage financing (geared to large loans over the long term) and the needs and financial capabilities of lower income borrowers (who may prefer smaller loans with shorter repayment periods which are not so heavily collateralised as traditional mortgages).¹⁵ They also build an interesting case for drawing the microfinance revolution that has swept some developing economies into the provision of affordable, sustainable accommodation for poorer people in every type of world region including the USA. In addition to improving the accessibility and sustainability of home ownership, this approach could also help secure the quality and condition of the stock by facilitating maintenance and repair.

On the other hand, there are more radical regulatory and interventionist options that could be considered. Muellbauer and Murphy (1997) have argued that a reform of property taxes may be essential to manage systemic risks around price volatility. Although the CML may not favour (Anderson, 2004), it could contain some exciting possibilities. Westaway (1993), who

¹⁵ Improving this fit might be criticised as a move towards two-tier mortgage lending, but it is unlikely to be any more divisive than the current system in which the wide range of sophisticated products and services available to higher income buyers is increasingly detached from the more restricted range of products (often with predatory conditions attached to them) available in the ‘subprime’ lending market.

attributed price volatility in the 1980s-90s to credit based effects has already argued for regulation to control the extent of over-mortgaging. It might be a short step from this to developing other measure to limit the amount of wealth stored in homes, allowing it to be diverted into other less individualised uses (including individual as well as social safety nets). In auction-based systems (the Scottish system being the archetype) prices paid in excess of property values could, for example, be diverted into a housing infrastructure fund and used to fund maintenance and repairs for low income owners. More radical still is the challenge of institutionalising an ethic of care – which is concerned with the interdependency of households and communities – into market practices which currently prize competitive individualism and private gain. Most of the risks to individuals documented in this report are effectively the risks that come from the individualisation of housing wealth, and of the losses as well as the gains which may arise from this. While challenging this may seem beyond the remit of the Joseph Rowntree Foundation’s enquiry, it would equally be out of step for a ‘think-tank’ on home ownership to ignore the struggle to reclaim markets for social ends which is now appearing in literatures from international political economy to science and technology studies, from the sociology of finance to the world of economic geography, from political philosophy to grass roots practice.

Looking Forward

Documenting, predicting and recommending what happens to home ownership between now and 2015 is of critical importance for the economy of the UK and for the wellbeing of households within and outside that tenure sector. Running through the different sections of this review is an indication that at least three areas of understanding might usefully be enhanced as a preface to securing a more inclusive, less risky, world of home ownership by 2010.

First, while the challenge of monitoring and measuring the housing economy is usually the remit of housing economists, the findings of this review point to the gains to be made from a more wide ranging transdisciplinary approach. There is scope for much more conversation between housing economists and other social researchers concerned with the economy of owner occupation. At the moment, for example, there is a division of labour between economic description and prediction for whole (national, regional or local) systems, on the one hand, and social critique, prescription and protection for the most vulnerable households on the other. This leaves little real energy for debate around some important themes

concerning price expectations and values, information and calculation, investment and consumption, and so on across the board. It leaves some core ideas driving housing decisions and transactions relatively unexplored, especially as far as their social, cultural and ethical dimensions are concerned. Yet housing studies is better placed than many other subjects to encourage the transfer of knowledge and ideas across a disciplinary divide (between social and economic research) which has often been unhelpfully entrenched. Any initiative designed to bring together housing economists and other social and environmental researchers exploring the economy of housing could address this gap in the interests of securing a sustainable future for the management of home ownership.

Second, there is currently far too little knowledge about the way home owning households – as occupants, as the consumers of financial services, as recipients of safety net services – routinely behave, and too little comprehensive understanding of what they want and need from home ownership. Lay perspectives on housing policies and practices around home ownership are few and far between,¹⁶ and even economic psychology still has some way to go in this area. There is, therefore, too little ‘close dialogue’ to underpin, challenge, or revise the dominant ‘stylised facts’ which are currently assumed to drive housing decisions. Moreover, when lay perspectives *are* drawn into the system, it is usually by way of qualitative interviews or focus groups providing illustrative experiences, or feedback on the terminology and language in product literature or in questionnaire survey design. There is enormous scope when considering the future of home ownership not only to develop a wider range of participatory research techniques (building on a tradition which JRF has traditionally favoured) but also to bring lay voices more fully into decision making processes. A recent attempt to apply ‘citizens jury’ techniques to complex debates on life insurance and genetic testing shows not only that a random cross section of citizens can get to grips with complex ideas in a relatively short space of time, but also that they are willing to work with subjects that hardly seem scintillating (how insurance underwriting works, for example!) if they feel the work is worthwhile (Bennett & Smith, 2005).

Finally, some intriguing and thought-provoking findings are now coming on stream from new data sources containing a longitudinal perspective on ownership experiences. While these fill some notable gaps, housing issues are often incidental rather than fundamental to the large panel surveys. As a consequence there is still too little life course data in the system. In particular there are too few opportunities to recognise and document the implications of a

¹⁶ Though a new project on the Origins of Security and Insecurity (OSIS) funded under the EU 6th framework programme ‘Citizens and Governance in a Knowledge Based Society’ may address some of these concerns

cohort effect, or of intergenerational impacts, when analysing the consequences of economic and policy shifts for ownership options, asset accumulation, savings, spending and debt. A panel survey of homebuyers would offer one solution to this rather glaring gap in the knowledge base underpinning the policies and practices shaping owner occupation as the 21st century unfolds.

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